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Meeting: IAASB Consultative Advisory Group

Meeting Location: New York

Meeting Date: September 9–10, 2013

Agenda Item C

Auditor Reporting

Objective of Agenda Item

1. To provide a report back on proposals of the Representatives on this project as discussed at the April 2013 CAG Meeting.

Project Status and Timeline

2. The Appendix to this paper provides a history of previous discussions with the CAG on this topic, including links to the relevant CAG documentation.

3. In June 2013, the IAASB unanimously approved its auditor reporting proposals. The exposure draft (ED) includes a proposed new ISA and a number of proposed ISAs (the Proposed ISAs) as follows:

   - Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* – Revised to establish new required reporting elements, and to illustrate these new elements in example auditor's reports.
   - Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report* – A new standard to establish requirements and guidance for the auditor's determination and communication of key audit matters. Key audit matters, which are selected from matters communicated with those charged with governance (TCWG), are required to be communicated in auditor's reports for audits of financial statements of listed entities.
   - Proposed ISA 260 (Revised), *Communication with Those Charged with Governance* – Amended required auditor communications with TCWG, including proposed communication about the significant risks identified by the auditor, in light of proposed ISA 701.
   - Proposed ISA 570 (Revised), *Going Concern* – Amended to establish auditor reporting requirements relating to going concern, and to illustrate this reporting within the auditor's report in different circumstances.
   - Proposed ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report* – Amended to clarify how the new required reporting elements of proposed ISA 700 (Revised) are affected when the auditor expresses a modified opinion, and to update the illustrative auditor's reports accordingly.
   - Proposed ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* – Amended to clarify the relationship between Emphasis of Matter paragraphs, Other Matter paragraphs and the Key Audit Matters section of the auditor's report.

4. The ED also includes an Explanatory Memorandum (EM) with questions for respondents and a summary of the IAASB's deliberations in developing the Proposed ISAs. This EM is included as a CAG Reference Paper, and has been distributed to the Representatives in PDF format, rather than via a hyperlink.

5. The ED is open for comment through November 22, 2013. **CAG Member Organizations are strongly encouraged to submit formal responses to the IAASB by this date.** Feedback from the formal responses to the ED will be considered by the Auditor Reporting Drafting Teams and IAASB in finalizing the Proposed ISAs. A summary of the responses to the ED will be presented to the CAG at its March 2014 meeting.

April 2013 CAG Discussion

6. Below are extracts from the draft minutes of the April 2013 CAG meeting,[1] and an indication of how the project Task Force or IAASB has responded to the Representatives' comments. In accordance with the manner in which the project was discussed at the April 2013 meeting (i.e., divided into two drafting teams), separate tables are included below for each of the drafting teams, as well as a section addressing overall comments.

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Representatives' Comments	Task Force/IAASB Response
OVERALL COMMENTS ON THE BASIS FOR, AND APPROACH TO, THE PROJECT	
Mr. Koktvedgaard, speaking on behalf of the CAG Working Group (WG) on Auditor Reporting, commended the IAASB for a tremendous job in conducting outreach throughout the project, and recognized the difficult task facing the IAASB in aligning the divergent views. Messrs. James and Kuramochi agreed.	Support noted.
Mr. Koktvedgaard noted that Agenda Item B.1 provided a very good overview of the responses to the ITC and the IAASB's discussions to date. He also recognized the significant efforts of the drafting teams and staff. Ms. de Beer and Messrs. Kuramochi and Waldron agreed that significant progress had been made to date.	Support noted.

[1] The minutes will be approved at the September 2013 IAASB CAG meeting.

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Representatives' Comments	Task Force/IAASB Response
Key Audit Matters (KAM) (Agenda Items B.2, B.3, and B.4)	
REVISED OBJECTIVE FOR KAM	
Mr. Waldron questioned, in light of the IAASB's decisions made at its February 2013 meeting, whether there was a possibility that the proposed objective would be reconsidered in light of the CAG's discussions.	Point accepted. Mr. Montgomery explained that the IAASB was of the view that the revised objective, and the resulting focus on the audit that was performed, was an appropriate way forward to respond to concerns raised by respondents. However, he noted the Representatives' reactions would be welcome and be further considered by the Drafting Team. Prof. Schilder agreed, noting the IAASB has a further opportunity to improve its proposals before the June ED. The IAASB subsequently agreed to simplify the proposed objective as follows: *The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.* [***See paragraph 6 of proposed ISA 701.***]
While supporting the proposed objective, Mr. Diomeda urged the IAASB to further consider whether the final standard will reach the goal of addressing the information and expectation gaps. He cautioned that, since auditors will be free to communicate what they believe is valuable information to users, the expectation gap could be widened if users are anticipating more information from auditors than can reasonably be delivered. Messrs. Hansen, James, Waldron and Uchino agreed that ensuring users' needs are met is paramount to the success of the project.	Point accepted. Further input from users will be gathered as part of the comment letter process, as well as through outreach. A detailed question has been specifically included in the ED as follows: *Do users of audited financial statements believe the introduction of a new section in the auditor's report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?* [***See Question 1 on page 23 of the Explanatory Memorandum (EM).***]

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Mr. Uchino agreed with the application material that noted the purpose of KAM was to provide additional transparency about the auditor's work in carrying out the audit. Mr. James suggested that, because of the nature of the project, certain stakeholder views (i.e. investors) should be given more weight.	Point accepted. Mr. Montgomery acknowledged the challenges of KAM delivering value to users, and was of the view that practice will evolve over time. In particular, Mr. Montgomery drew the Representatives' attention to paragraphs 2–3 of Agenda Item B.3, which are intended to explain the purpose of communicating KAM and the benefit to users. He explained that the IAASB was of the view that a post-implementation review a few years after the standard is effective would be useful to ensure the intended benefits of KAM were being achieved. Prof. Schilder noted that dialogue will be needed with not only auditors to ensure they are appropriately implementing the standard, but also users and TCWG to ensure they understand the purpose of KAM and can consider auditors' reports appropriately. [***See paragraphs 40–41 of the EM and paragraphs 2–3 and A2–A5 of proposed ISA 701.***]
Mr. Morris, supported by Mr. Hemus, suggested that further clarity about the concept of matters that are of most significance in the audit would be useful. Specifically, they questioned whether this was from the auditor's perspective about the audit, or whether it was related to the accounting considerations, and if the objective needed to be placed in the context of the audit findings. Ms. Blomme noted a focus on the performance of the audit and the risk-based approach in the audit may help to clarify the objective. Mr. Hemus noted that the proposed objective could be seen as fairly open-ended, insofar as the auditor may wish to communicate about matters such as an inability to communicate with TCWG in an emerging market, because this was significant to the auditor. Mr. Hansen was of the view that matters determined to be KAM should be those few items that "keep the auditor awake at night."	Point accepted. Mr. Montgomery explained the intent was to require the auditors to describe the matters that were of most significance in performing the audit of the financial statements, but that the IAASB was seeking to find a fairly condensed and succinct way to articulate the objective. He also noted that the objectives of the ISAs are aimed at auditors, and the requirements, application material and scope material need to adequately support the objective of the ISA. Ms. de Beer agreed that the objective cannot be read in isolation, and that the requirements and other material in the ISA attempt to explain that understanding the areas of most significance in the audit will help users understand the entity. The IAASB agreed with the principle that the KAM

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	to be communicated in the auditor's report are primarily related to areas of significant auditor attention in performing the audit. As noted above, the IAASB agreed to further simplify the objective of proposed ISA 701. The IAASB also revised the definition of KAM and the proposed requirement for auditors to determine KAM as follows: *Key audit matters*—Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with TCWG. The requirement to determine key audit matters has been articulated as follows: *The auditor shall determine which of the matters communicated with those charged with governance are the key audit matters. In making this determination, the auditor shall take into account areas of significant auditor attention in performing the audit, including:* *(a) Areas identified as significant risks in accordance with ISA 315 (Revised)*[2] *or involving significant auditor judgment.* *(b) Areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence.* *(c) Circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control.*

2 ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

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	[***See paragraphs 42–45 of the EM and paragraphs 7–8 and A1–A24 of proposed ISA 701.***]
Mr. Koktvedgaard questioned whether the auditor's consideration of KAM was in relation to the planning phase of the audit or after the audit was concluded, as well as how communication about KAM related to significant risk. Particularly, he questioned whether everything reported as KAM would have been assessed as a significant risk. Mr. Stewart was of the view that, due to the risk-based approach of an audit conducted in accordance with ISAs, such significant risks would be included in KAM, as proposed.	Point taken into account. Proposed ISA 701 acknowledges that the auditor may develop a preliminary view at the planning stage about matters that are likely to be the KAM in the audit and may communicate this with TCWG when discussing the planned scope and timing of the audit in accordance with proposed ISA 260. Proposed ISA 260 now requires the auditor's overview of the planned scope and timing of the audit to include communication about the significant risks identified by the auditor. However, it is not a given that all KAM would have been identified as significant risks, as the concept of "significant auditor attention" is broader. The factors in the requirement to determine KAM include not only significant risks, but other areas of significant auditor attention, such as difficulties encountered during the audit or circumstances that required significant modification of the auditor's planned approach to the audit, as users have expressed an interest in understanding these matters. [***See paragraphs 8 and A6 of proposed ISA 701 and paragraphs 15 and A11a of proposed ISA 260 (Revised).***]
NEW PROPOSED ISA 701	
Mr. Diomeda questioned why it was necessary to develop a new standard relating to KAM.	Point noted. Mr. Montgomery explained that the IAASB had considered incorporating this material in proposed ISA 700 (Revised) but had concluded that, since the discussion of KAM in the auditor's report is a new and significant change in practice, the significance of the auditor's effort might be lost if

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	the requirements were subsumed in an existing standard. He also noted that the detailed requirements for certain other auditor reporting elements are included in standards other than proposed ISA 700 (for example, ISA 706 and proposed ISA 720 (Revised)[3]). Prof. Schilder further explained that the IAASB was of the view that having a separate standard would reduce complexity and that, given the length of proposed material addressing KAMs, it would likely result in proposed ISA 700 being unbalanced, as such material is only required for listed entities.
Mr. Waldron reiterated the view that investors would value consistency and comparability between the IAASB and PCAOB initiatives.	Point noted. Mr. Montgomery gave a personal view that the IAASB's thinking was reasonably consistent with the approach discussed at the PCAOB November 2012 Standing Advisory Group (SAG) meeting and subsequent discussions with the PCAOB Board members and Staff. Mr. Baumann agreed that a focus on helping investors understand the audit was not inconsistent with the PCAOB's thinking in principle. He noted the PCAOB's timeline was similar to the IAASB's but also needs to take into account coordination with the US Securities and Exchange Commission and an economic analysis now required by US legislation. The PCAOB released its proposals addressing auditor reporting on August 13, 2013. IAASB Staff will review the PCAOB's proposals and the Drafting Team will consider whether there are areas where further alignment in the direction of the respective Boards' standards would be helpful or desirable.

3 Proposed ISA 720 (Revised), *The Auditor's Responsibilities for Other Information in Documents Containing or Accompanying the Audited Financial Statements and the Auditor's Report Thereon*

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FACTORS IN DETERMINING KAM	
Mr. Kuramochi suggested a need for the IAASB to ensure it is reflecting the comments made by respondents to the ITC in the ED. He was of the view that the implications of changes to the auditor's report will likely be tested with the next audit failure. Specifically, he questioned whether leaving the matters to be included in the auditor's report to the auditor's judgment was appropriate in light of the feedback from the ITC. In his view, investors would like to understand whether the auditor had performed a high-quality audit and therefore it may be appropriate for the objective to be linked to audit quality in some manner. Mr. Diomeda agreed.	Point taken into account. Mr. Montgomery explained that users and other respondents to the ITC supported the auditor using professional judgment to determine which matters to communicate in the auditor's report and did not suggest specific matters that should be required to be communicated in all cases. Prof. Schilder was of the view that the value of KAMs will likely evolve as auditors consider how best to discuss such matters in the auditor's report in a manner that does not result in standardized language. The IAASB continues to believe that the entity-specific matters to be communicated in the auditor's report should be a matter of professional judgment, rather than the IAASB designating certain items as key audit matters that would be required to be communicated in all circumstances. Nevertheless, there are areas relating to matters of significance in the audit that have been consistently mentioned by investors, regulators and others that would be anticipated to be communicated with TCWG and about which additional information could be provided in the auditor's report. Further, there was a strong view in response to the ITC that appropriate guidance would be necessary to adequately inform the auditor's decision-making and foster consistency in auditor's reports across similar entities. The IAASB has therefore developed the related application material in proposed ISA 701 with this in mind, and is of the view that the proposed requirement and guidance, taken together, provide a sufficient basis for the auditor's decision-making process. While not explicitly addressed within the objective

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	of proposed ISA 701, the link to audit quality is highlighted for readers in the EM as follows: *Because the auditor's report is the key deliverable addressing the output of the audit process for users of the audited financial statements, the IAASB is of the view that changes in auditor reporting may have positive benefits to audit quality or users' perception of it.*[4] *This in turn may increase the confidence that users have in the audit and the financial statements, which is in the public interest.* [***See paragraphs 7–8 of the EM and paragraphs 7–8 and A1–A24 of proposed ISA 701.***]
Mr. Hemus expressed concern that leaving the matters to be disclosed to the auditor's professional judgment may result in a lack of comparability, for example between two similar entities.	Point taken into account. Mr. Montgomery explained that the factors in the auditor's decision-making process would be expected to be applied for both entities and it would be likely that the auditors of the two entities would have had similar communication with TCWG about these matters. He acknowledged that the proposed requirement in paragraph 16 of the proposed ISA 701 [in the material presented at the April 2013 CAG meeting] allowed for flexibility of what might be communicated on the matters in the auditor's report. However, the IAASB was of the view that it was important for proposed ISA 701 to allow for flexibility for auditors to communicate in a manner they believe is best and most understandable for users. Also, while consistency is potentially desirable on some level, it may not be achievable give the use of auditor judgment in determining the KAM to be communicated and the intent to make the description of the matters as entity-specific as possible.

[4] As explained in the IAASB's recent consultation document, *A Framework for Audit Quality*

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	See also the response to the prior comment.
Mr. Baumann questioned whether the requirement as drafted would limit the auditor to consider only the matters communicated with TCWG as KAMs. He was concerned that there may be other significant matters that had been discussed with management that the auditor and management agreed did not need to be discussed with TCWG. Mr. Hansen was of the view that auditors generally do not often like to admit they had difficulty in the audit, but that auditors should be required to explain to TCWG the reasons for the difficulties (for example, whether due to poor planning by the auditor or failures by management).	Point not accepted. Mr. Montgomery explained that ISA 260[5] requires the auditor to communicate with TCWG significant matters discussed with management and significant difficulties encountered during the audit. In developing proposed ISA 701, the IAASB focused on the interest expressed by users of the financial statements in those matters about which the auditor and TCWG had the most robust dialogue – for purposes of understanding areas of significant auditor attention in performing the audit – and the calls for additional transparency about those communications. The IAASB considered the communications with TCWG required by ISA 260 and other ISAs to ensure they were sufficient as a basis for key audit matters, and determined that limited amendments to the required auditor communications with TCWG were necessary in light of proposed ISA 701. [***See paragraphs 15–16 and A11–A20a of proposed ISA 260 (Revised).***]
Messrs. Finnell and Hemus questioned whether auditors would be limited to a particular number of KAMs. In Mr. Finnell's view, two to three KAMs would generally be appropriate and would require the auditor, particularly of a large entity, to need to think carefully about which three matters to discuss. Mr. Diomeda was of the view that, since the selection of matters was based on the auditor's judgment, it was necessary to ensure the auditor could include as many KAMs as the auditor considered necessary in the context of the particular audit.	Point taken into account. Mr. Montgomery explained that the ITC, while noting the final decision was left to the auditor's judgment, indicated a range of two to ten matters would generally be appropriate. Respondents to the ITC noted that a fewer number was preferred, and proposed ISA 701 included application material highlighting the possibility of range of two to seven matters, as many auditors requested guidance on what would generally be appropriate in order to provide a consistent steer for the

5 ISA 260, *Communication with Those Charged with Governance*

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	auditor's decision-making. The IAASB did not support specifying a range or limit to the number of KAM that may be included in the auditor's report. However, proposed ISA 701 explains that the number of KAM to be included in the auditor's report may be affected by the size and complexity of the entity, the nature of its business and environment, and the facts and circumstances of the audit engagement. It also highlights that the greater the number of KAM, the less useful the auditor's communication of KAM may be. The illustrative reports in Appendices 1 and 2 of proposed ISA 700 (Revised) include 2 and 4 KAM examples, respectively, to provide a further signal to respondents. [***See paragraph A7 of proposed ISA 701.***]
Ms. Blomme was of the view that the matters included as KAMs are not all the matters that were discussed with TCWG. Mr. Stewart agreed, but was of the view that it is the nature and complexity of the matter itself, not necessarily the nature and extent of the communication with TCWG, that should drive whether a matter is a KAM. Mr. Stewart and Ms. Manabat were of the view that the approach of leveraging communication with TCWG was sensible and appropriate.	Point accepted. The IAASB agreed it was not necessary to make reference to the nature and extent of communication with TCWG about a particular matter as a reason why such a matter may be a KAM.
Mr. Stewart noted that matters that were considered sources of estimation uncertainty should be appropriately disclosed in the financial statements in accordance with International Financial Reporting Standards (IFRS).	Point accepted. The IAASB agreed that proposed ISA 701 should explicitly note that the discussion of KAM is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or a remedy for material misstatement of the financial statements relating to non-disclosure of information required to be disclosed. [***See paragraph A34 of proposed ISA 701.***]
Ms. Manabat was of the view that giving further	Point accepted.

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transparency to significant matters communicated with TCWG was appropriate, in particular as it may result in TCWG paying greater attention to management's disclosures in the financial statements and engaging in greater dialogue with the auditor about these matters.	This expected benefit is explicitly noted in the EM. [***See paragraph 8 of the EM.***]
Ms. Blomme and Mr. Grund agreed there would likely always be at least one KAM in the audit of a listed entity. In Ms. Blomme's view, there would likely be a negative perception if the auditor of a listed entity included a statement of "nothing to report" in the auditor's report.	Point accepted. Mr. Winter was of the view that there may not be KAMs for certain smaller listed entities that, for example, may be dormant. While agreeing that explaining that having no KAMs to report would be expected to be relatively rare, Mr. Baumann noted that research done by the PCAOB had indicated a significant amount of dormant listed entities. The IAASB accepts that it is conceivable that there may be certain limited circumstances (e.g., a listed entity that has very limited operations or assets) in which, in the auditor's judgment, there are no KAM to communicate in the auditor's report. If the auditor concludes that there are no KAM to communicate, proposed ISA 701 requires the auditor to discuss this conclusion with the engagement quality control reviewer, where one has been appointed, and communicate this conclusion with TCWG. Proposed ISA 701 would also require a statement in the auditor's report that there are no KAM to report. The ED includes an explicit question about whether it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no KAM to communicate. [***See paragraphs 59–62 and Question 6 of the EM and paragraphs 13 and A47–A48 of proposed ISA 701.***]
Mr. Kuramochi was of the view that auditors generally avoid written communication about critical issues relating to fraud and other sensitive matters. Messrs. Hemus and Kuramochi questioned whether discussing such matters in the auditor's report would be appropriate. Mr. Baumann urged the	Point taken into account. Mr. Montgomery also noted that the Drafting Team had considered whether there are some matters that should not be communicated in the auditor's

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Drafting Team to consider whether the proposed application material in paragraph A28 that explained such circumstances was appropriate, as some could use such guidance to avoid discussion of most matters. He raised the example of circumstances where the most significant risk in the audit is the quality of the individuals in the key roles of the CEO and CFO, who exercise influence over the financial statements as a whole. In his view, this could result in a significant deficiency in entity-level internal control, which should be communicated as a KAM, due to the pervasive effect on the financial statements. Mr. Morris noted that there are frequently circumstances in which the auditor meets with TCWG without management present. Mr. Morris also noted that topics covered during those sessions relating to management may not be appropriate to report externally.	report, primarily because it may be difficult to describe such matters succinctly in the auditor's report without the benefit of two-way communication. Mr. Montgomery noted the IAASB had not yet considered the wording [of paragraph A28], but it would be important not to give too much flexibility to avoid communicating matters because of the auditor's judgment about their "sensitivity." He suggested the auditor's description of sensitive matters could explain that the auditor had spent a significant amount of time discussing the particular matter with TCWG. The IAASB agreed that it was important not to prohibit the auditor from communicating about sensitive matters if they were determined to be KAM, but was of the view that it was necessary to clarify application material to highlight challenges in communicating KAM, for example in relation to KAM that are seen to be more sensitive, including KAM relating to fraud risks or significant deficiencies in internal control. [***See paragraphs A35–A36 of proposed ISA 701.***]
Mr. White noted that the illustrative report included introductory language to explain the purpose of KAMs in the context of the overall audit. In his view, it would be unlikely that there were matters discussed in KAM that had not been disclosed in the financial statements, due to potential liability issues. Mr. Hemus suggested it may be useful to clarify that expectation.	Point taken into account. Prof. Schilder noted the IAASB needed to reflect on liability risks, either in circumstances when the auditor discussed a matter that was not disclosed in the financial statements, but also when the auditor decided not to disclose a particular matter that later became problematic. The IAASB agreed it would be useful to require introductory language to the Key Audit Matters section in the auditor's report to explain its purpose and provide important context. However, the IAASB did not believe it was appropriate to infer that certain matters may not be discussed as KAM due to liability issues (see comment above). [***See paragraph 9 of proposed ISA 701 and the***

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	Illustrations in the Appendices of proposed ISA 700 (Revised) in relation to the introductory language and paragraphs A34–A36 of proposed ISA 701 in relation to challenges in communicating KAM.]
Mr. Peyret agreed that users may be more likely to question the accounting in relation to matters in the auditor's report. He was of the view that it will be necessary to educate users about the purpose of KAMs to minimize confusion.	Point noted. Mr. Montgomery noted that many respondents to the ITC, including preparers and auditors, had expressed concern about the auditor providing original information about the entity, and this approach sought to ensure users could focus on the disclosures describing the accounting implications of the matters that were highlighted by the auditor. The IAASB also agreed it would be useful to require introductory language to the Key Audit Matters section in the auditor's report to explain its purpose and provide important context. [***See paragraph 9 of proposed ISA 701 and the Illustrations in the Appendices of proposed ISA 700 (Revised).***]
Mr. Waldron noted that the CFA Institute surveys had indicated that investors would like to know more about the materiality levels applied in the audit. In his view, it would be appropriate for the IAASB to consider including guidance on whether auditors should discuss materiality in the auditor's report.	Point taken into account. Mr. Montgomery explained that only a limited number of respondents to the ITC highlighted the need for a discussion of materiality in the auditor's report, with auditors and preparers expressing concern that users may not be able to appropriately interpret such information. He noted that the Drafting Team would give further consideration to the matter in light of the UK Financial Reporting Council's (FRC) consultation on a similar requirement. The IAASB does not believe certain matters related to the planning and scoping of an audit (such as a description of the materiality applied to the engagement) would meet the definition of a KAM. In light of feedback from respondents to the

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	ITC, the IAASB does not consider it appropriate to establish a requirement for the auditor to disclose such matters in the auditor's report. Nevertheless, the auditor may judge it appropriate, or be required by law or regulation or national standards, to do so as part of an Other Matter (OM) paragraph. The IAASB agreed that proposed ISA 706 (Revised) should acknowledge this. [***See paragraph A8 of proposed ISA 706 (Revised).***]
Mr. Hansen questioned the impact of year-to-year reporting of KAM and whether the auditor would need to update KAMs or explain why an issue noted as a KAM in the prior year was no longer considered a KAM.	Point taken into account. Mr. Montgomery explained the Drafting Team had not yet fully considered the issue, but was initially of the view that the auditor's decision-making process on KAM was based on the current year audit. In his view, certain matters may be most important in one year but could be less important in the next year, but acknowledged some may wish for auditors to address this. The IAASB concluded that the determination of KAM should be limited to those matters of most significance in the audit of the financial statements of the current period, even when comparative financial statements are presented. The EM explains the practical considerations discussed by the IAASB in reaching this conclusion, notably that users are interested in the most recent information possible to make informed decisions, and therefore are more likely to value information from the auditor about the audit of the current period. The ED includes an explicit question about this topic. [***See paragraphs 63–65 and Question 7 of the EM and paragraphs 8 and A8–A9 of proposed ISA 701.***]

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Mr. James noted recent inspection findings by the International Forum of Independent Audit Regulators (IFIAR) indicated that auditors are not consistently identifying significant deficiencies in internal controls. In light of this, he questioned how many KAMs would be noted in practice relating to significant deficiencies in internal controls.	Point taken into account. One of the factors in the requirement in proposed ISA 701 to determine whether a matter is a KAM relates to "circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control." ISA 265 requires the auditor to communicate in writing significant deficiencies in internal control identified during the audit to TCWG on a timely basis.[6] The auditor is not required by the ISAs to report externally on significant deficiencies in internal control identified during the audit. However, the identification of a significant deficiency may be an indicator of a key audit matter relating to the area(s) of the financial statements affected by the significant deficiency. However, nothing in proposed ISA 701 affects the auditor's work effort to determine significant deficiencies in internal control in accordance with ISA 265, so it is not possible to draw a conclusion regarding how many KAMs may be noted in practice relating to significant deficiencies in internal control. [***See paragraphs 8(c) and A23 of proposed ISA 701.***]
Mr. Koktvedgaard questioned whether it was necessary to consider matters other than those that were significant risks in determining KAMs.	Point not accepted. Mr. Montgomery explained that the Drafting Team wished to make a strong link to the consideration of significant risks identified both at the planning stage and during the audit. However, he noted that the findings from Phase II of the ISA Implementation Monitoring project had indicated that auditors may not consistently be classifying

[6] ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 9

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	certain matters as significant risks, for example, accounting estimates with a high risk of material misstatement. Mr. Montgomery explained that the Drafting Team did not want to limit KAMs to matters classified as significant risks so that the scope could be sufficiently broad, but was of the view that it was useful to give a strong steer in proposed ISA 701 about the relationship between significant risks and KAM. Mr. Montgomery further noted the Drafting Team's proposals to strengthen communication with TCWG about significant risks through revisions to ISA 260. [***See paragraph 8 of proposed ISA 701 and paragraph 15 of proposed ISA 260 (Revised).***]
ILLUSTRATIVE EXAMPLES	
Mr. Koktvedgaard noted the CAG WG had divergent views on value and appropriateness of the examples, but was of the view that the IAASB would learn more from respondents to the ED. He explained that some WG members were of the view that the examples were not necessarily beneficial but rather an enhanced explanation of the auditor's responsibilities rather than the auditor's approach to the audit, but that it was also important to consider whether the examples were harmful.	Point taken into account. The IAASB further refined the examples at its June 2013 meeting. The ED includes an explicit question about this the usefulness and informational value of the individual examples. [***See paragraphs 51–53 and Question 4 of the EM and Illustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised).***]
Mr. Kuramochi noted the illustrative examples will send an important message to auditors implementing proposed ISA 701, both in terms of the topics that may be selected and the level of detail that should be included in the auditor's report. He suggested it would be useful to provide an example of a more sensitive situation.	Point accepted. The IAASB developed an example addressing revenue recognition of long-term contracts, which includes reference to the risk of material misstatement due to fraud with respect to revenue recognition. The EM highlights this is likely to be a sensitive area because the reference to a risk of fraud is not likely to be disclosed in the financial statements. [***See paragraphs 51–53 and Question 4 of the EM and Illustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised).***]

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Mr. Waldron noted that, while the examples included new information, he was not convinced that the examples would be responsive enough to the calls from investors for more insight from auditors, in particular the auditor's views on accounting policies.	Point noted. Mr. Montgomery explained that the development of illustrative examples had been the most challenging to the IAASB and the Drafting Team. He acknowledged that the IAASB may not ever be able to fully meet the demands of users and investors but was seeking to improve practice, and he was of the view that the auditor saying something about matters that were significant in the audit would signal users should pay attention to those matters and further engage with management and TCWG about them. Mr. Montgomery explained the IAASB would seek to further strengthen the examples before exposure, but would need to be clear in the ED how the IAASB had arrived at the examples and why they are structured the way they are. Mr. Sylph agreed, noting that it was important for the model to be flexible enough to allow for auditors to discuss the most important matters in any particular audit so that it can evolve over time. [***See paragraphs 51–53 and Question 4 of the EM and Illustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised).***]
Mr. Kuramochi also noted that IOSCO was of the view that a case study could be a useful analysis to determine the appropriate level of detail in the description of KAM, for example on an entity such as Enron, to determine whether users would have found value and gained insight into the potential issues facing the entity by reading KAMs. Mr. Waldron agreed. In Mr. Kuramochi's view, the true value of changes to auditor reporting will be tested with the next audit failure.	Point noted. Within the EM, the IAASB strongly encourages audit firms and public sector equivalents to "field test" the application of proposed ISA 701 during the exposure period. A staff-prepared document highlighting considerations that may be of assistance to those who plan to undertake filed testing is available on the IAASB's website. [***See paragraphs 17–22 of the EM.***]
Mr. Koktvedgaard questioned whether it was necessary to include an example of the auditor's discussion of the overall audit process, in particular the approach to tests of controls	Point not accepted. While the illustrative examples included in the Proposed ISAs highlight certain aspects of tests of

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and substantive testing.	controls and substantive testing, the IAASB did not consider it necessary to develop an example of the auditor's overall approach in light of the way in which KAM are defined (i.e., by reference to individual matters rather than the overall approach).
Mr. Morris was of the view that the examples addressing goodwill and financial instruments were appropriate in light of the interaction between audit and accounting issues, and addressed topics that were likely to be considered KAMs. However, he was of the view that the example of an unusual transaction could be replaced with an example of a matter identified as a significant risk.	Point accepted. The new example *Revenue Recognition Relating to Long-Term Contracts* relates to a significant risk due to fraud. [***See llustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised).***]
Mr. Hines noted the difficulties in separating auditing from accounting issues in the descriptions of KAMs. In the financial instruments example, he was of the view that it was unclear whether the use of an entity-specific valuation model would have been required by the financial reporting framework or whether management had a choice of models. Mr. Finnell noted that the matter of valuation of financial instruments would be a standardized disclosure for a financial institution and suggested industry-specific guidance may be appropriate.	Point taken into account. The IAASB further refined the example relating to valuation to highlight management's choice in determining an appropriate model. The IAASB accepts that certain matters included in KAM may be more consistent across entities in some industries, but given that these may meet the threshold of "most significance," there would be value in them discussed as KAM. [***See Illustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised).***]
Mr. Diomeda questioned why the illustrative example about financial instruments included a conclusion while the other two examples did not. Mr. Thompson was of the view that the examples would be enhanced if the auditor discussed whether misstatements had been identified relating to the matter or if the auditor confirmed the auditor's view that the disclosures in the financial statements were appropriate. Ms. de Beer highlighted the concern that users may interpret such conclusions as piecemeal opinions or separate assurance on the matter.	Point noted. The EM explains that different approaches have been taken intentionally in developing the illustration of individual KAM. This has been done to show how an auditor's judgments about the nature and extent of the description, and the information to include, in explaining KAM may vary depending on the situation. [***See paragraphs 51–53 and Question 4 of the EM and Illustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised).***]

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Mr. White suggested greater transparency about what caused the auditor to determine a particular matter as a KAM would be appropriate. Mr. Grund agreed this would be useful.	Point accepted. The IAASB agreed that the crux of the requirement to communicate KAM should be for the auditor to explain why the auditor considered the matter to be one of most significance in the audit (i.e., to provide insight about why the matter was determined to be a KAM). [***See paragraph 48 of the EM and paragraph 10 of proposed ISA 701.***]
Messrs. Diomeda and Grund questioned the need for the disclaimer in the contextual language. Mr. Morris was of the view that such language was generally important but could be further streamlined. Mr. Thompson preferred the language used in the ITC. Mr. White suggested it would be more appropriate to explain what value the user might derive from understanding KAM, and suggested that language in paragraph 2 of proposed ISA 701 could usefully be included in the auditor's report.	Point taken into account. Mr. Montgomery noted the new language was developed in response to concerns raised by preparers and auditors that it needs to be clear to users that the discussion of KAM in the auditor's report is not a comprehensive list of matters discussed with TCWG. The IAASB sought to reduce the length of such language while retaining the key messages to enable users to understand the purpose of the section (and what was not intended by the communication). [***See paragraph 9 of proposed ISA 701 and the Illustrations in the Appendices of proposed ISA 700 (Revised).***]
PROPOSED CHANGES TO ISA 260	
Mr. Bluhm inquired whether the revised requirements in ISA 260 were intended to apply to all auditors or only auditors of listed entities who would be required to include KAMs in the auditor's report. He noted some concern from small and medium practices (SMPs) that there would be an increase in the scope of an audit.	Point not accepted. Mr. Montgomery confirmed that the requirements would apply to all audits, but that the Drafting Team did not believe there would be a significant incremental burden for auditors of small- and medium-sized entities (SMEs) to communicate about significant risks or significant unusual transactions if applicable.
Mr. Bluhm suggested that this could be further clarified in	Mr. Montgomery was of the view that such

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the ED and views solicited to ensure such changes are appropriate. Messrs. Diomeda and Morris agreed that such revisions may only be appropriate for listed entities to mirror proposed ISA 701. Mr. Koktvedgaard suggested ISA 260 could be restructured to more clearly articulate which requirements were applicable only to listed entities.	enhancements to ISA 260 would likely be useful in practice, even if auditors were not required to include KAMs in the auditor's report and that these communications were scalable in cases where auditors of entities other than listed entities included KAMs in the auditor's report. The IAASB believes it is in the public interest to establish this requirement for audits of financial statements of all entities, not only for listed entities. It is not expected to result in a significant burden on auditors who are not required to communicate key audit matters in the auditor's report (e.g., auditors of entities other than listed entities), as proposed ISA 260 (Revised) remains flexible for such communication to be made orally. [***See paragraphs 69–73 of the EM and paragraph 15 of proposed ISA 260 (Redrafted).***]
Mr. White agreed that the proposed revisions to ISA 260 were appropriate, because an expected benefit of proposed ISA 701 is to improve communication between the auditor and TCWG. He was of the view that the communication proposed by the changes to ISA 260 are likely to already be taking place and therefore not cause a significant incremental burden, but that clarification of the need for such communication would be useful. Mr. Baumann agreed, noting that the additions would make improvements to audit quality by requiring a robust discussion of some of the most important aspects of the audit. He explained that the PCAOB had given consideration of the incremental costs in proposing its auditing standard addressing communication with TCWG and had concluded that, because there was no additional work effort, communicating what is already expected to be documented should not be overly burdensome. He noted that increased communication with TCWG could result in additional time being spent by audit committees but that such communication would enable them to better carry out their responsibilities.	Support noted.

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Messrs. Bluhm, Koktvedgaard, Kuramochi and White were of the view that it may be appropriate to require written communication with TCWG about those matters included as KAMs in the auditor's report. However, Mr. Koktvedgaard cautioned that this could result in a voluminous communication as the auditor would be required to communicate the audit plan to TCWG, and urged the IAASB to specifically request feedback on this matter in the ED.	Point taken into account. While the IAASB was of the view that it was important for proposed ISA 260 (Revised) to remain flexible for communication with TCWG to be made orally or in writing, the IAASB agreed that the fact that a discussion of a matter would be included in the auditor's report may affect the auditor's determination about which form of communication was more appropriate, and agreed that guidance to this effect would be useful. [***See paragraph A38 of proposed ISA 260 (Redrafted).***]
Mr. Peyret was of the view that communication should always be in writing to provide evidence of the discussions in case of disputes with the entity. Mr. Grund noted the recent guidance from the Basel Committee set out an expectation that communication with TCWG would always be in writing, but also introduced the concept of proportionality, relating to size, complexity, structure, economic significance, and the risk profile of a bank.	Point not accepted (see above).
Mr. Peyret also noted the need for the IAASB to consider Article 23 of the proposed European Commission (EC) legislation.	Point noted. The Drafting Team has been mindful of the provisions and believes proposed ISA 260 (Revised) is sufficiently flexible to accommodate the provisions of Article 23, recognizing that the ISA is intended to be principles-based, with the possibility that law or regulation may provide further specificity.
Mr. Kuramochi suggested it may be useful to consider whether the factor in the proposed ISA 701 to consider the difficulty of the judgment involved in determining KAM was adequately aligned with ISA 260. Mr. Montgomery noted this was intended to be addressed by paragraph 16 of proposed ISA 260 (Revised), but that further application material may be useful to align the two standards.	Point accepted. In finalizing the requirement in paragraph 8 of proposed ISA 701 relating to the determination of KAM, the IAASB agreed changes were needed to proposed ISA 260 (Revised) to clarify the interaction between the two standards. [***See paragraph 73 (and the chart that follows***

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	that paragraph) of the EM and paragraph 16 of proposed ISA 260 (Redrafted).]
Mr. Diomeda suggested flexibility regarding the form of communication with TCWG was appropriate. He noted that, in SME audits, discussions with TCWG occur on a daily basis and a more stringent written requirement would be burdensome. Mr. Baumann agreed, noting that the PCAOB's auditing standard allows for similar flexibility because so much of the communication with TCWG are oral, and such communication is an iterative process depending on what management has already communicated to TCWG. Rather than requiring communication with TCWG to always be in writing, the PCAOB agreed that requiring the auditors to document the substance of their communication with TCWG would be more appropriate. Mr. Koktvedgaard suggested that the audit committee minutes could serve as a record of the communication.	Point accepted (see above).
INCLUDING KAMS WHEN THE AUDITOR'S REPORT IS MODIFIED	
Mr. Hansen noted that adverse opinions are so rare that it may not be necessary for the IAASB to specify what is necessary in such circumstances. Mr. Koktvedgaard noted this was consistent with the views of the CAG WG.	Point not accepted. The IAASB was of the view that a discussion of KAM would still be relevant to enhancing users' understanding of the audit and therefore the auditor should be required to communicate KAM even when an adverse opinion is expressed.
Mr. Hemus noted that the International Monetary Fund had received disclaimers of opinions for auditors of central banks and there may be useful information that could be communicated as KAMs in such circumstances. Ms. Lopez agreed.	Point not accepted. The IAASB is of the view that any discussion of KAM other than the matter(s) giving rise to the disclaimer of opinion may suggest that the financial statements are more credible in relation to those matters than would be appropriate in the circumstances and would be inconsistent with the disclaimer of an opinion on the financial statements as a whole. [***See paragraph 58 of the EM.***]

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DOCUMENTATION	
Mr. Baumann noted the proposed documentation requirement was unclear and appeared to suggest that the auditor's rationale for the decision-making process surrounding KAM should be documented. In his view, what is important from a reviewer's perspective is what was discussed with TCWG and the engagement quality control reviewer. He suggested a focus on documenting those matters that the auditor did not consider to be KAMs would be more appropriate.	Point taken into account. Mr. Montgomery agreed that further clarification could be helpful. The IAASB agreed that proposed ISA 701 should include a requirement for the auditor to document the matters that will be communicated as KAM, and the significant professional judgments made in reaching this determination, in accordance with ISA 230. Proposed ISA 701 explains that both the written communications with TCWG and other audit documentation may assist the auditor in developing a description of key audit matters that explains the significance of the matter. The IAASB has also proposed amendments to the application material in ISA 230 to support the documentation requirement in proposed ISA701. [***See paragraphs 66–68 of the EM and paragraphs 14 and A32 of proposed ISA 701, as well as the Proposed Conforming Amendments to Other ISAs.***]
KAM FOR AUDITS OF ENTITIES OTHER THAN LISTED ENTITIES	
Mr. Hansen suggested flexibility was necessary, to enable auditors to consider whether it would be appropriate to include KAMs in the auditor's report in the context of the audit. However, he was of the view that, once an auditor of an entity other than a listed entity decided to include KAMs, such decision should not be changed each year.	Point taken into account. Proposed ISA 701 allows for the possibility that auditors of financial statements of entities other than listed entities may decide to communicate KAM on a voluntary basis. The standard does not explicitly address the point that once an auditor decides to include KAM it should be done every year, but the EM includes a question on the overall topic of KAM for other than listed entities. [***See paragraphs 54–57 and Question 5 of the EM.***]
Mr. Hemus noted that practice for entities other than listed will likely evolve over time. In his view, preparers will likely	Point noted.

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want to consider whether the inclusion of KAMs on a voluntary basis is viewed as a positive approach, or whether it is seen as negative.	
Messrs. Bluhm, Hemus and Stewart and Ms. Lopez suggested agreement with management and TCWG at an early stage would be appropriate. Mr. Stewart noted the benefits of the communication of KAMs may warrant the IAASB further considering whether KAMs should be required for all entities. Messrs. Bluhm, Stewart, Thompson and Waldron agreed that when KAM is included it should be done in a similar manner as listed entities, as differential reporting is not useful.	Point accepted. The IAASB agrees it is important, if KAM are communicated for audits of financial statements of entities other than listed entities (either voluntarily or when required by law or regulation), that such matters should be determined and communicated in the same manner as for listed entities. In light of the possibility of auditors of other than listed entities communicating key audit matters in the auditor's report, or being requested by management or TCWG to do so, the IAASB has proposed limited amendments to ISA 210, *Agreeing the Terms of Audit Engagements*. Specifically, if the auditor of the financial statements of an entity other than a listed entity is not required to communicate key audit matters but intends to do so, a new requirement has been established for the auditor to include a statement in the audit engagement letter regarding such intent. This is both a relevant practical consideration and one important to the principle that the form and content of the auditor's report is the sole responsibility of the auditor. In addition, application material clarifies that in certain jurisdictions it may be necessary for the auditor to include a reference to the possibility of communicating key audit matters in the terms of the audit engagement in order to retain the ability to do so (e.g., due to legal or regulatory requirements, including those relating to confidentiality). [***See paragraphs 54–57 of the EM, paragraph 4 of proposed ISA 701 and paragraphs 30 and A30–A31 of proposed ISA 700 (Revised)).***]

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Mr. Diomeda suggested the auditor of an entity other than a listed entity could alert management and TCWG about the possibility of the auditor including KAMs in the auditor's report when the engagement is accepted, rather than seek explicit agreement from TCWG before including KAM in the auditor's report.	Point accepted (see above).
Mr. Bluhm noted the discussion about KAM for entities other than listed entities would be further informed by the IAASB's determination about how to treat the Other Matter paragraphs going forward.	Point accepted. Prof. Schilder agreed. The IAASB believes it is necessary to retain the mechanisms of Emphasis of Matter (EOM) and Other Matter (OM) paragraphs for all entities. After considering and defining KAM, the IAASB specifically evaluated how EOM and OM paragraphs could best be retained in light of the requirement to communicate key audit matters for audits of financial statements of listed entities, and how the interaction of such communications should be articulated within the Proposed ISAs. [***See paragraphs 74–79 and Question 8 of the EM and proposed ISA 706 (Revised).***]
ISA 700 Issues (Agenda Items B.5, B.6 and B.7)	
CONSISTENCY, RELEVANCE, AND FLEXIBILITY, INCLUDING THE EFFECTS OF LAW, REGULATION, AND NATIONAL AUDITING STANDARDS ON AUDITOR REPORTING	
Mr. Koktvedgaard noted that the CAG WG was of the view that the IAASB should mandate the ordering of the elements in the auditor's report. The WG members believed having consistency in the ordering of the elements in the auditor's report would be beneficial in ensuring that important information in the auditor's report is conveyed with the same level of prominence and emphasis that the IAASB intends and would avoid confusion that a different presentation may be interpreted as an issue in the audit. He was of the view that it was unnecessary to incorporate another layer of flexibility beyond allowing law or regulation to prescribe a different order. Ms. de Beer asked whether	Point not accepted. Feedback from the ITC included views that, in some countries, there are cultural reasons why placement of certain elements, for example the auditor's opinion at the end of the report, is preferred. As a result, the IAASB concluded that proposed ISA 700 (Revised) should not mandate the ordering of the elements of the auditor's report. With the exception of the requirement in extant ISA 700 for an introductory paragraph, this is largely consistent with extant ISAs 700, 705 and 706, and represents an important degree of

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the CAG WG had views as to whether the specific wording within the sections of the auditor's report should be mandated. Mr. Koktvedgaard responded that, for most sections of the auditor's report, such as the opinion paragraph, the wording should essentially be the same, so as to maintain consistency in the information communicated to users, but that some flexibility may be needed. He noted that the only differences that should exist in the auditor's report should be because of law or regulation.	flexibility in presentation. However, the IAASB believes its overall approach to specifying requirements in proposed ISA 700 (Revised) and its application in terms of the wording used in the illustrative reports represents an appropriate balance between consistency in auditor reporting globally and the need for flexibility. The ED asks a specific question about the appropriateness of the IAASB's approach, including the decision not to mandate the ordering of sections in the auditor's report in any way. [***See paragraphs 104–109 and Question 14 of the EM.***]
Mr. Thompson strongly recommended that the IAASB maintain the level of flexibility that exists within extant ISA 700 so that jurisdictions can continue to have the ability to tailor requirements relating to the content and layout of the auditor's report based on specific national circumstances through law or regulation.	Point accepted.
Mr. Waldron was of the view that it was important to have consistency in the placement of the "pass/fail" opinion upfront in the auditor's report, but that the IAASB could allow flexibility in the placement of the other elements of the auditor's report.	Point not accepted (see above).
EXPLICIT STATEMENT OF COMPLIANCE WITH ETHICAL RESPONSIBILITIES	
Mr. Koktvedgaard expressed support for the new requirement, in particular the explicit reference to independence, but suggested that proposed ISA 700 (Revised) should also require that the auditor's report include a reference to the specific code with which the auditor is required to comply with in respect of independence.	Point accepted. Mr. Winter explained that many different independence requirements may apply to a large multinational audit, which could result in a lengthy disclosure in the auditor's report if the auditor was required to name all sources of independence requirements. He highlighted application material that explained that the auditor may be required by law or regulation to include more specific

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	information about compliance with ethical requirements, such as a reference to the specific independence code, in the auditors' reports. The IAASB agreed to require disclosure of the source(s) of the relevant ethical requirements, but posed a question in the ED to further explore the practical challenges raised by Mr. Winter. [***See paragraphs 89–94 and Question 11 of the EM and paragraph 28(c) of proposed ISA 700 (Revised).***]
Mr. Morris further emphasized the existence of varied ethical rules and independence codes across jurisdictions and suggested that an approach similar to the one taken in dealing with different accounting frameworks could be useful, whereby in a group audit a common denominator is determined for purposes of establishing a framework for auditor reporting and reference is made to a specific ethics code in the auditor's report. Mr. Fleck agreed that an explicit reference to the source(s) of the relevant ethical requirements would be appropriate.	Point accepted. The IAASB agreed to required disclosure of the source(s) of the relevant ethical requirements, and highlighted the matter explained by Mr. Morris. [***See paragraphs 28(c) and A28–A29 of proposed ISA 700 (Revised).***]
Mr. Baumann suggested that, because it is not uncommon for auditors to violate and remedy independence rules during the course of an audit engagement, having a definitive statement about compliance may be misleading to users. Mr. James agreed that it would be inappropriate for the auditor to state compliance if the auditor had not complied with all relevant ethical requirements. Mr. Baumann added that, in the US, auditors would not be able to make such a statement because the existence of a violation would not constitute compliance with all of the ethical code, including independence rules.	Point taken into account. Mr. Winter responded that the IESBA *Code of Ethics for Professional Accountants* (IESBA Code) was recently revised to include provisions for dealing with breaches of independence requirements. Ms. Healy further explained that the IESBA Code adopts a safeguards and threats approach, and establishes a framework that requires auditors to identify, evaluate, and address threats to independence. In such cases, while the auditor has not complied with all independence requirements, the auditor is able to assert that the auditor is independent of the entity because TCWG have concurred that any breaches of independence requirements have been appropriately addressed. The IAASB agreed that the proposal originally

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	presented to the CAG should be reconsidered in light of the possible implications of breaches of independence requirements. The statement no longer explicitly refers to compliance but as follows: We are independent of the Company within the meaning of [*indicate relevant ethical requirements or applicable law or regulation*] and have fulfilled our other responsibilities under those ethical requirements. This statement is included in the Basis for Opinion section of the illustrative reports.
Mr. Stewart noted that the use of the title "Independent Auditor's Report" was an implicit statement of compliance.	Point noted.
Mr. Fleck agreed that the use of the phase "compliance with" caused difficulties in the case of breaches and suggested revising the statement to parallel the statements relating to which auditing and accounting standards applied to the engagement. Mr. Baumann noted that such a statement would be interpreted differently from the one presented in the proposed illustrative auditor's report. Mr. James disagreed and suggested that, in his personal view, with respect to the IESBA Code even when there is an independence violation, auditors could still say that they were compliant, if they did what the Code calls for – which could simply be reporting the matter to TCWG.	Point accepted. The IAASB agreed that the proposal originally presented to the CAG should be reconsidered in light of the possible implications of breaches of independence requirements. The IAASB also consulted with the IESBA about the revised statement regarding independence, noting their support for the IAASB's proposals.
Mr. James added that some members of IOSCO questioned whether investors would also want to know about breaches, and suggested that those breaches also be reported in the auditor's report.	Point not accepted. The IAASB believes the impediments of public disclosure of breaches of independence would likely outweigh the value, and did not agree to require disclosure in the auditor's report. [***See paragraphs 95–97 of the EM.***]
Mr. Hines suggested that the requirement in ISA 260 for the auditor of a listed entity to communicate with those TCWG about independence should be expanded to all entities.	Point not accepted. The IAASB was of the view that this would be a more substantive change than would be

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	appropriate in light of the mandate of the Auditor Reporting project and the minimal changes contemplated to ISA 260.
ENHANCED DESCRIPTIONS OF THE RESPONSIBILITIES OF MANAGEMENT, TCWG, AND THE AUDITOR	
Mr. Koktvedgaard noted that there was support among WG members for the proposed requirement permitting auditors to relocate the description of the auditor's responsibilities to a website when law or regulation permits. Ms. de Beer further probed by asking whether the IAASB should mandate the exact wording to be used on the website. Mr. Koktvedgaard suggested that the exact words to be used on the website need not be mandated. Ms. Blomme and Messrs. Bluhm and Fleck agreed.	Point accepted. Mr. Winter responded that, while there may be merit in mandating the exact words to be included on the website, the Drafting Team had determined it would be appropriate to require that the description on the website be consistent with what would otherwise be required to be included in the auditor's report, to allow for flexibility to describe other concepts. The IAASB agreed, and proposed ISA 700 (Revised) therefore allows for some flexibility for a broader description of the auditor's responsibility on a website. [***See paragraphs 39–40 and A37–A41 of proposed ISA 700 (Revised).***]
Ms. Blomme noted that a similar mechanism now exists in Europe and that, while some countries were not supportive of it when it was first adopted, many have now embraced it. Mr. Fleck agreed, explaining that, in the UK, the FRC allows auditors the option of relocating the description of auditor's responsibilities to a website and a number of major accounting firms use this option. The UK FRC determined that the website was a viable option because investors did not want to read standardized language in every report as they were already familiar with the concepts. He noted that the UK stakeholders cited benefits of not only less standardized information in the auditor's report, but also the flexibility to have a more detailed description of the audit on the website, though he noted that such description is close to the description that would be required to be used in the auditor's report.	Support noted.

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Messrs. Hansen and Waldron expressed a contrary view, noting a preference for having the description of the auditor's responsibilities within the auditor's report. Mr. Waldron added that investors prefer to have all information about the audit available in one location. Mr. Hansen noted that, from a regulatory perspective, there was a preference for having all the information in the auditor's report.	Point not accepted. Proposed ISA 700 (Revised) does not mandate such information to be outside of the auditor's report. However, the IAASB was of the view that permitting relocation would be appropriate in light of the feedback from the ITC.
Ms. Blomme questioned whether, if not relocated to a website, the length of the material to describe the auditor's responsibilities was appropriate.	Point noted. The IAASB was of the view that the length was generally appropriate in light of feedback that further clarity about the auditor's responsibilities and the nature of an audit may help to narrow the expectations gap.
Mr. Diomeda questioned the statement in the auditor's responsibility section that explained "Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements." He noted that misstatements are considered in the aggregate so the use of the phrase "individually or in the" was redundant. Mr. Diomeda was also concerned that the phrase "could reasonably be expected to influence the economic decisions of users" was difficult to understand.	Point not accepted. The IAASB was of the view that such phrases are rooted in the ISAs and generally understood, and therefore should not be revised at this time.
Mr. Koktvedgaard expressed support for a short and concise description of management's responsibilities for the financial statements in the auditor's report. He also expressed support for having additional guidance in proposed ISA 700 (Revised) that allowed for a cross-reference to a location to where a further description of management's responsibilities is included.	Support noted. Proposed ISA 700 (Revised) notes the possibility of the auditor's report referring to a more detailed description of management's responsibilities. [***See paragraphs A33–A34 of proposed ISA 700 (Revised).***]
Ms. Blomme suggested it may be necessary to reinstate the description of management's responsibilities relating to going concern.	Point taken into account. The IAASB is of the view that the manner in which the Going Concern language is articulated balances management's and the auditor's responsibilities; however, it is not as explicit as the

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	language used in the ITC and is now all placed in the Going Concern section. [***See the Illustrations in the Appendices of proposed ISA 700 (Revised) and proposed ISA 570 (Revised).***]
Mr. Koktvedgaard suggested that proposed ISA 700 (Revised) should require that the auditor's report include a statement about quality control procedures in accordance with ISQC 1.[7] He also questioned why the IAASB standards do not make explicit reference to other standards issued by IFAC.	Point not accepted. The IAASB did not believe this change was necessary, as ISQC 1 applies to audit firms, rather than individual audits.
DISCLOSURE OF THE NAME OF THE ENGAGEMENT PARTNER	
Messrs. Grund, Hansen, Hemus, Koktvedgaard, Stewart and Waldron expressed strong support for requiring the name of the engagement partner to be included in the auditor's report, but acknowledged that the auditor reporting project should not be compromised if the IAASB is unable to conclude on disclosing the name of the engagement partner.	Point taken into account. The IAASB agreed to require disclosure of the name of the engagement partner for audits of financial statements of listed entities. In light of the diverse views about the appropriateness of such a requirement and the manner in which it is articulated in proposed ISA 700 (Revised), the IAASB agreed to include a specific question soliciting feedback in the EM. [***See paragraphs 98–101 and Question 12 of the EM and paragraphs 42 and A45 of proposed ISA 700 (Revised).***]
Mr. Hansen did not support the inclusion of a "harm's way exemption" and suggested that threats of such significance could raise questions about an engagement partner's independence.	Point not accepted. The IAASB believes the "harm's way" exemption, which is already done in some national jurisdictions where disclosure of the name of the engagement paper, is appropriate.

[7] International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

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	[***See paragraphs 42 and A45 of proposed ISA 700 (Revised).***]
Mr. Waldron acknowledged the debates in the US about disclosing the name of the auditor's report, as well as the concerns expressed by auditors, and was of the view that other improvements to auditor reporting, in particular KAM, were of greater importance.	Point noted.
Mr. Koktvedgaard suggested that there is a public interest benefit in having the name of the engagement partner in the auditor's report. He added that it is difficult for investors to easily track information about breaches of independence, or conflicts of financial interests, if the name of the engagement partner is not disclosed in the auditor's report. Mr. Koktvedgaard further added his view that audits are all about people and that when different engagement partners are involved in the audit, the public should know.	Point accepted. [***See paragraphs 98–101 of the EM.***]
Messrs. Hemus, Grund, and Stewart suggested that the proposed requirement also applied to entities other than listed entities. Mr. Hemus suggested that the IAASB consider making the requirement applicable to PIEs. Mr. Grund suggested the disclosure could also be required for systemically important financial institutions (SIFIs).	Point not accepted. Mr. Winter explained that the focus on listed entities was due to demand coming primarily from institutional investors (i.e. users of listed entity financial statements), and that the proposed "harm's way" exemption was put forth as a compromise in order to align with requirements in jurisdictions, such as the EC, where disclosure of the engagement partners name is already required. Mr. Winter cited feedback from respondents to the ITC about the challenges in determining a global definition for PIEs that would be universally understood. The IAASB concluded it would be appropriate to limit the requirement in proposed ISA 700 (Revised) to audits of financial statements of listed entities. This is because the demand for such transparency has primarily come from institutional investors and, for many non-listed entities, including SMEs, the engagement partner's name is already available or known to the users of the

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	financial statements through other means, albeit informal in many circumstances. The EM notes that the post-implementation review planned for two years after the Proposed ISAs become effective will assist the IAASB in determining whether wider application of the proposals initially limited to listed entities would be in the public interest.
Mr. Stewart added that the construct of "unless otherwise publicly available" would make retrieving the name difficult for users.	Point accepted. The IAASB agreed to remove this language from the final requirement included in proposed ISA 700 (Revised)
Mr. Morris was of the view that the IAASB should determine what is best, particularly since most jurisdictions already have such a name disclosure requirement. He noted that the ISAs would not apply in the US for listed entities, but acknowledged that the US Auditing Standards Board was not supportive of a proposed requirement due to liability concerns. However, he suggested this should not preclude the IAASB from moving forward with a proposed requirement. He also suggested the proposed standard be drafted in a manner that would allow jurisdictions that adopt the revised ISA 700 to depart from having to comply with the new requirement to disclose the name of the engagement partner when law or regulation determines it necessary or permissible to do so.	Point noted. Mr. Winter noted an alternative would be to leave the decision to require disclosure of the name of the engagement partner to national standard-setters (NSS) in light of liability issues unique to each jurisdiction. Mr. Winter noted, however, that some may view this as the IAASB missing an opportunity to take a leadership position on enhancing transparency.
GOING CONCERN	
In relation to the proposed approach to auditor reporting on going concern, Ms. de Beer indicated that, based on her observation, the IAASB CAG's views to date have been for the IAASB to move forward on going concern in the auditor reporting project and not wait for the accounting standard setters to complete improvements to the financial reporting frameworks, as this can take a long time.	Support noted.
Mr. Stewart provided an IASB staff update on the status of	Points noted.

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the IASB's going concern project. He noted that the objective of the IASB's going concern project was not to change the fundamentals of financial statement preparation using the going concern basis of accounting, but instead to clarify when a material uncertainty exists and what financial statement disclosures are needed in such circumstances. Mr. Stewart also reported that the IASB is planning to consider staff proposals on this topic in May 2013 and it will likely be at least a year before the project would be finalized. Such proposals are expected to focus on disclosing events and conditions that would likely cause an entity to fail, before considering any mitigating actions that management might take, and presenting those mitigating factors as well as a conclusion as to whether a material uncertainty exists. Mr. Baumann commented that the IASB approach in principle sounded very similar to the current approach being considered by the US Financial Accounting Standards Board (FASB). Mr. Baumann then asked about whether the IASB and FASB were planning to explore convergence as the going concern projects progressed towards completion. Mr. Stewart responded that the IASB and FASB are closely liaising, and actively monitoring each other's work.	
Ms. Blomme noted that the EC proposals related to auditor reporting were explicit about auditor reporting with respect to going concern, but remained silent in the accounting directive revision about changes to management reporting responsibilities related to going concern. She added that there is an understanding in the European community that the EC proposals will be updated to include provisions for management to confirm that the financial statements have been prepared using the going concern basis of accounting. Ms. Blomme indicated that it was important for the auditor's report to include an explicit statement about management's responsibility with respect to going concern. She also re-emphasized FEE's support for having going concern statements in the auditor's report for audits of all entities.	Point taken into account. Mr. Winter acknowledged Ms. Blomme's comments and the importance of having a more explicit statement about management's responsibility with respect to the use of the going concern assumption in preparing the financial statements. Mr. Winter agreed that explicit statements by management about both the use of the going concern assumption and the identification of material uncertainties would provide a useful basis for auditor reporting. The IAASB is of the view that the manner in which the Going Concern language is articulated balances management's and the auditor's responsibilities. However, it is not as explicit as the language used in the ITC and is now all

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	placed in the Going Concern section.
Mr. Koktvedgaard suggested that the proposed wording relating to going concern in the illustrative auditor's report and the proposed requirement should be revised to more explicitly accommodate the various accounting frameworks. Mr. White agreed, noting that the illustrative example was drafted on the basis of IFRS.	Point taken into account. The illustrative wording included in the EM was drafted on the basis of IFRS. IAASB Staff consulted with IASB staff to solicit views on the proposed language in light of the accounting requirements. [***See Illustrations 1 and 2 in the Appendix of proposed ISA 700 (Revised).***]
Mr. Koktvedgaard questioned whether it was necessary to have a separate going concern section in the revised illustrative auditor's report and suggested that the IAASB allow jurisdictions the flexibility to determine the placement of additional information about going concern in the auditor's report. For example, he suggested that the IAASB consider the possibility that a jurisdiction may determine it necessary to have law or regulation that requires going concern matters be reported as KAMs in all circumstances, or have it be included as part of the overall conclusion in the opinion section. Mr. Thompson added that, in a situation where the auditor spends a lot of time on going concern issues, it would likely also be a KAM in addition to required reporting in the going concern section.	Point not accepted. Mr. Winter acknowledged Mr. Koktvedgaard's view, noting that his suggestion had been previously explored but, in light of the strong steer received from respondents to the ITC and other stakeholders, in particular the EC, it was necessary to have statements about going concern featured prominently in the auditor's report. Point noted. The identification of a material uncertainty related to going concern would, by its nature, be a KAM. However, the IAASB is of the view that information relating to the identification of a material uncertainty relating to going concern should be presented as part of the *Going Concern* section of the auditor's report to give it appropriate emphasis (rather than in the *Key Audit Matters* section). However, in such circumstances the introductory material in the Key Audit Matters section would make reference to the material uncertainty and the *Going Concern* section. Nothing in proposed ISA 701 would preclude the auditor from including a KAM relating to going concern in cases when the auditor has not identified a material uncertainty relating to going concern.

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	[***See paragraph 11 of proposed ISA 701 and Illustration 1 in the Appendix of proposed ISA 700 (Revised).***]
Mr. Baumann cited concerns about the wording of the going concern section, and believed that the wording would be unhelpful to users and could potentially cause more confusion rather than reducing the expectation gap. Specifically, Mr. Baumann suggested that the concepts explained in the first two sentences of the section contradicted each other and commingled the topics of the use of the going concern assumption and the basis of accounting. Mr. Stewart agreed, highlighting that there might be events and conditions that indicate that an entity might fail, before mitigating factors have been considered. Mr. Stewart noted that, if there are still material uncertainties after such mitigating factors, there is a net risk that should be disclosed. Mr. Baumann also noted that an inability to discharge liabilities does not indicate that the use of the going concern assumption is inappropriate, as entities can be in bankruptcy proceedings for many years, and that the concept of the "foreseeable future" was more closely linked to material uncertainties. Finally, Mr. Baumann was of the view that, while the statement relating to the identification of material uncertainties was more useful than the conclusion on the appropriateness of the going concern assumption, which he did not support, users will likely have difficulty understanding the nature of the auditor's disclosures unless the language is further revised.	Point accepted. The IAASB further evolved the illustrative wording of the Going Concern section. In addition, the EM highlights the concern that users may not understand the intent of the auditor's statements on going concern and asks an explicit question in that regard. Because respondents to the ITC emphasized the need for a more holistic approach to addressing going concern in financial reporting, the IAASB has been actively liaising with accounting standard setters. The IAASB will need to carefully consider the status and planned actions of the accounting standard setters when finalizing its auditor reporting proposals to determine the best course of action, which may involve deferring finalization of auditor reporting related to going concern. ***See paragraphs 80–88 and Questions 9–10 of the EM, and proposed ISA 570 (Revised).***]
Mr. White expressed support for Mr. Baumann views, and asked for clarification as to whether the first paragraph of the illustrative auditor's report is framework-specific.	Point noted. The illustrative example has been aligned with the financial reporting requirements in IFRSs.
Mr. Stewart also suggested editorial suggestions to the going concern section, including more closely aligning the first two sentences with the wording that exists under the accounting framework.	Point accepted. IAASB Staff consulted with IASB staff to solicit views on the proposed language in light of the accounting requirements.
Mr. Koktvedgaard questioned whether the auditor would	Point not accepted.

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include an Emphasis of Matter (EOM) paragraph when a material uncertainty had been identified, suggesting that the sub-heading "Disclosures about Material Uncertainties" be replaced with the more familiar term "Emphasis of Matter." Mr. Koktvedgaard was of the view that using an EOM heading would appropriately draw users' attention to the fact that the auditor's report was unusual.	Ms. Healy clarified that extant ISA 570 allows flexibility to use a heading titled "Emphasis of Matter" or another suitable title when a material uncertainty exists and is properly disclosed in the financial statements. She noted that the Drafting Team had concluded that a more tailored heading would be appropriate and, in such circumstances, that the statement about material uncertainties should be positioned within the GC section. Mr. Montgomery explained that the trigger for such disclosure would not differ from extant ISA 570, and that respondents to the ITC saw merit in including all reporting relating to going concern in a separate section prominently placed in the auditor's report. The EM explains the key changes from ISA 570, including that the identification of a material uncertainty relating to going concern will no longer be a required EOM paragraph. [***See paragraphs 87–88 of the EM, and paragraph 22 of proposed ISA 570 (Revised).***]
Mr. Waldron acknowledged the views expressed on the illustrative text relating to going concern, noting that it was a very interesting debate. He added that he agreed with elevating the importance of going concern by having a separate section about it upfront in the auditor's report. However, investors are more concerned with just having the new information available in the auditor's report. Mr. Waldron also expressed concerns for the wording included, stating that some of it may be too standardized.	Point taken into account.
Mr. Koktvedgaard also suggested that in the case of an adverse auditor's opinion, a going concern section would not be necessary.	Point not accepted. Because adverse opinions can be issued for a variety of matters, the IAASB was of the view that information from the auditor about going concern would still be relevant even when an adverse opinion was expressed.

Matter for CAG Consideration

7. The Representatives are asked to note the Report Back above, in particular the changes made as a result of the CAG's comments.

Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Explanatory Memorandum included in the Exposure Draft (pages 1-42 of the Exposure Draft)	Distributed as a PDF
Exposure Draft, *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)* [Includes the Explanatory Memorandum (EM) and the Proposed ISAs]	https://www.ifac.org/publications-resources/reporting-audited-financial-statements-proposed-new-and-revised-international

Appendix

Project History

Project: Auditor Reporting

<u>Summary</u>

	CAG Meeting	IAASB Meeting
Report of IAASB Working Group – key findings from academic research studies on user perceptions of the standard auditor's report	March 2010	December 2009
Issues Paper and IAASB Working Group Proposals	-	December 2010
Development of Proposed Consultation Paper	March 2011	March 2011 May 2011
Consultation – May 2011		
Further Discussion	September 2011	
Discussion of Project Proposal and Issues	March 2012	December 2011 March 2012
Discussion of the Invitation to Comment	September 2012	April 2012 June 2012
Discussion of Feedback from Invitation to Comment and Development of the Exposure Draft	April 2013 September 2013	September 2012 December 2012 February 2013 April 2013 June 2013

<u>CAG Discussions: Detailed References</u>

Report of IAASB Working Group – key findings from	<u>March 2010</u> See IAASB CAG meeting material:

academic research studies on user perceptions of the standard auditor's report	http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=5253 See CAG meeting minutes (in Agenda Item D of the following material): http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=5882 See report back on March 2010 CAG meeting (in paragraph 12 of the following material): http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6095
Development of Proposed Consultation Paper	March 2011 See IAASB CAG meeting material: http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6095 http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6096 See CAG meeting minutes (in Agenda Item M of the following): http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemA-Final_March_2011_Public_Minutes_APPROVED-v1-03.pdf See report back on March 2011 CAG meeting (in paragraph 1 of the following): http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemH1-Auditor-Reporting-V1-02.pdf
Further Discussion	September 2011 See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemH-Auditor-Reporting-V1-02.pdf http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemH1-Auditor-Reporting-V1-02.pdf See CAG meeting minutes (in Agenda Item H of the following material): http://www.ifac.org/sites/default/files/meetings/files/20120306-IAASBCAG-Agenda_Item_A-September_2011_Public_Minutes-APPROVED.pdf
Discussion of the Project Proposal and Issues	March 2012 See IAASB CAG meeting material included in Agenda Items G, H, K, L and M: http://www.ifac.org/meetings/brussels-belgium See CAG meeting minutes (in Agenda Items G, H, K, L, and M of the following): http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-Agenda_Item_A_March%202012_Public%20Minutes-APPROVED.pdf See report back on March 2012 CAG meeting: http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-Agenda_Item_F1-Auditor_Reporting_Report_Back-v4.pdf
Discussion of the Invitation to Comment and Development of the Exposure Draft	September 2012 See IAASB CAG meeting material: http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-Agenda_Item_F1-Auditor_Reporting_Report_Back-v4.pdf See CAG meeting minutes (in Agenda Item F of the following): http://www.ifac.org/sites/default/files/meetings/files/20130408-IAASB-CAG-Agenda_Item_A-Public_Minutes-v5-APPROVED_0.pdf
Discussion of Feedback from Invitation to	April 2013

Comment and Development of the Exposure Draft	See IAASB CAG meeting material included in Agenda Items B, B.1., B.2, B.3, B.4, B.5., B.6 and B.7. http://www.ifac.org/meetings/new-york-usa-1 See CAG meeting minutes (in Agenda Item B of the following): See draft minutes included as Agenda Item A of the September 2013 CAG Meeting. See report back on April 2013 CAG meeting: See the report back in paragraph 6 of this paper.